PERAC Pension News

No. 17

A publication of the Public Employee Retirement Administration Commission — *January 2008*

2008 PUBLIC PENSION INSTITUTE

By Joseph E. Connarton
Executive Director

In late September, PERAC asked public pension board members and administrators to reserve Sunday, August 17 through Tuesday, August 19 for the 2008 PERAC Public Pension Institute to be held at the Amherst campus of the University of Massachusetts.

Joseph E. Connarton

If you haven't already blocked this time out for the Institute, I encourage you to take a moment to do so. At the last Pension Institute, held in 2002, it was gratifying to see the interaction that took place between PERAC and retirement board members and administrators. Responses to the survey about that event were uniformly positive and time does not seem to have diminished its value. In fact, one board administrator recently wrote, "PERAC Institute – so valuable last time it was held. Hope it is bi- or tri-annual now."

We recognize that participating in the Institute will entail being away from job responsibilities and for many, home as well, for two days. However, it is our shared mission to administer the 106 public pension systems in a professional, prudent, and efficient manner. And just as the work we all do day in and day out sends a strong

(Continued on page 4)

MOTOR VEHICLE REGULAR COMPENSATION CASE TO BE HEARD BY THE SUPREME JUDICIAL COURT

By Judith Corrigan
Deputy General Counsel

In the last issue of the *PERAC Pension News*, we reported that the first of the motor vehicle cases to make its way through the court system was awaiting oral argument in the Appeals Court of Massachusetts. We can now report that the case of Pelonzi and PERAC v. Beverly Retirement Board and CRAB has been removed to the Supreme Judicial Court (SJC) of Massachusetts. The case was removed to the Court *sua sponte*, meaning that the Court took the case up on its own initiative.
This case involves one individual, Kenneth Pelonzi, the retired public safety commissioner and fire chief of the City of Beverly. Mr. Pelonzi argues, as does PERAC, that the personal use of his employer-supplied motor vehicle should be included in his regular compensation for retirement purposes. Now that the SJC will be hearing the case, the issue of whether the value of the personal use of an employer-supplied motor vehicle should be included in regular compensation should be fully and finally resolved as to all retirees and active members of the retirement systems. Oral arguments in the case will not be held until sometime after January 11, 2008.

Also In This Issue

→ 2007 DISABILITY TRAINING SESSIONS
→ TAKING STOCK OF STOCKS
→ CASH RESERVES AND THE CREDIT CRUNCH
→ PERAC STAFF DEVELOPMENTS

Public Employee Retirement Administration Commission
Five Middlesex Avenue, Suite 304
Somerville, MA 02145
ph 617 666 4446
fax 617 628 4002
web www.mass.gov/perac

2007 PERAC REGIONAL DISABILITY TRAINING SESSIONS CONCLUDE WITH A HEALTHY RESPONSE FROM BOARDS

A 2003 Training Initiative Has Evolved Into a Rewarding Experience For The Retirement Boards and PERAC Staff

By Frank Valeri
Deputy Director
&
Barbara Lagorio
Director of Disability

The November 15th regional disability training session held at PERAC in Somerville concluded this year's series of such trainings. In 2007, PERAC held 6 regional training sessions, which attracted a total of 88 individuals from 58 different retirement boards. Although the optimal class size seems to involve no more than 20 participants, that number has been exceeded on occasion due to popular demand. No one is ever turned away!

Seated from the left: Kate Hogan, Barbara Lagorio and Regina Manning. Standing: Jane Carritte, Tracy Legaski, Doreen Duane, and Patrice Looby.

In 2003, PERAC began reaching out informally to those retirement boards that requested assistance with disability retirement procedures and management of the related complex medical issues. Disability Director Barbara Lagorio organized a team of Disability Unit staff members to conduct site visits to each board that sought assistance. By 2004, the disability team was meeting with 10-15 boards annually.

In 2005, the strategy shifted and the Disability Unit began to meet with multiple retirement boards in group settings. This educational approach had the added benefit of giving board staff members an opportunity to share their individual experiences and interact with their peers from other retirement boards.

Within a year, the format evolved into a more formal regional training concept which was approved by Executive Director Joseph E. Connarton. Many retirement boards graciously offered to host regional training sessions. The regional training concept has proven to be a very effective means of fulfilling a vital component in PERAC's mission statement to provide guidance to the 106 retirement systems.

Kate Hogan, PERAC's manager of medical services, is responsible for coordinating the sessions. Each session includes information about disability medical panels, comprehensive medical evaluations (CME), returning to service (RTS), and benefit calculations. We currently have two traveling teams from the Disability Unit. Information about the medical panel process is presented by Kate Hogan and Regina Manning, administrative assistant. Patrice Looby and Jane Carritte, nurse case managers, focus on CME and RTS. Also, Scott Henderson, actuarial analyst, provides information on calculations and Workers' Compensation offsets.

A 2008 schedule of tentative dates and locations for upcoming disability training sessions will be released in January. Please feel free to contact Disability Director Barbara Lagorio with your training requests. All boards will receive notice of each of the training dates.

The Commission and its staff greatly appreciate the efforts of all retirement boards who have hosted training sessions. We thank others for volunteering their facility for future sessions and welcome all such offers.

TAKING STOCK OF STOCKS

By Robert A, Dennis, CFA
Investment Director

It's been written — and generally accepted as true — that 90-95% of investment return is determined by asset allocation. Nevertheless, this statement is of questionable usefulness unless asset allocation is extended to include subclasses and styles. For instance, in the equity market, the past decade has seen wide differentials in annual returns between large and small cap stocks, growth and value, and among industrial sectors. In non-traditional asset classes such as real estate, alternative investments (venture capital, private equity, etc.) and hedge funds, there are not only numerous subclasses and discrete strategies within each but returns vary greatly between top and bottom tier managers.

For stocks, typically the largest asset class in pension fund portfolios, performance has been traditionally and consistently diverse. Through the bubble years of the late 1990s, large caps trounced small caps. Throughout the current decade until the end of 2006, the trend was decisively reversed as small caps handily beat large caps each year. Similar trends occurred simultaneously for growth vs. value styles during these years.

These trends have been decisively reversed in 2007. Through November 30, large caps outperformed small caps by about 8% and growth has outperformed value by about 12%, according to the Russell indices. Large caps typically perform better in the later stages of an economic cycle and they also have more exposure to the faster growth occurring outside the U.S.

Performance differentials have been even more dramatic this year among industrial sectors within the S&P 500. Through November 30, the energy sector (benefiting from high oil prices) was up 23.40%, while materials and utilities rose 18.95% and 15.77%, respectively. On the other hand, consumer discretionary stocks declined 9.87% and financials (battered by the ongoing credit crisis) have fallen by 16.04%. Thus, while the S&P 500 overall was up 4.43% (6.23% total return, including dividends), the performance differential between top and bottom industrial sectors has been a startling 39%.

This year's performance has been a

(Continued on page 4)

FRANK VALERI ASSUMES KEY SENIOR MANAGER'S POSITION OF DEPUTY DIRECTOR OF PERAC

Frank Valeri, former chief of staff to Senator Thomas M. McGee, was recently named deputy director of PERAC by Executive Director Joseph E. Connarton. Mr. Valeri, a graduate of Providence College, brings a lengthy career in public policy development and pension oversight to the agency. In welcoming Mr. Valeri to the agency, Executive Director Connarton states, "Frank has an encyclopedic knowledge of state government. He brings that and his past experience and understanding of this agency to the table. I am happy to have been able to offer a man with such experience and integrity a senior level position with the Commission."

Frank Valeri

First appointed to Speaker David Bartley's research staff in 1975, Mr. Valeri subsequently held senior policy positions with several joint legislative committees, including the Joint Committee on Public Service. Mr. Valeri served as advisor to the committee members and House and Senate leadership in the policy areas of public pensions, employee benefits, insurance industry, municipal finance, land use, and governmental reorganizations.

After his tenure with the legislature, he was appointed in 1998 as the first legislative liaison for the newly created Public Employee Retirement Administration Commission. He interacted on the Commission's behalf on pension matters before the legislature, the governor's office, and the individual retirement boards.

Returning to the state legislature in 2002, Mr. Valeri served as chief of staff to Senator Thomas M. McGee and, as part of his responsibilities, acted as advisor on public pension legislation. While coordinating the operations of the senator's office he also assisted in the successful passage of significant pension legislation. More recent public pension changes included the updating of the statutory change of the Option (C) mortality table, formulation of local early retirement programs, and the establishment of a reinstatement to the workforce process for public retirees.

As deputy director of PERAC, Frank Valeri will be overseeing several operational departments: the Disability Unit, which coordinates medical examinations and reviews for disability retirements and disabled retirees; the Audit Unit which conducts the statutorily required audits of all retirement systems; and the Fraud Unit, also created by law to address pension fraud cases.

CASH RESERVES AND THE CREDIT CRUNCH

Robert Dennis, CFA
Investment Director

What began as an episode seemingly confined to a handful of hedge funds early last summer has mushroomed into a full-blown financial debacle that may end up rivaling the savings and loan crisis of the 1980s in terms of its wide impact. Some of the largest Wall Street firms and several of our largest commercial banks have been rocked by huge losses arising from investment vehicles secured by sub-prime mortgages. Most recently, even some money-market investment funds and pools have been found to own some potentially toxic instruments.

Money market funds are traditionally among the safest investments available but many, whether run by government entities or private investment managers, have been marketed as "enhanced" cash funds that are designed to take slightly greater risk in return for slightly higher yield. Government-run enhanced cash reserve funds in the State of Florida, Orange County (CA), and King County (WA) have been among those impacted by having investments in SIVs, or Structured Investment Vehicles. These previously obscure instruments are basically commercial paper, a type of short-term investment issued by corporations that has long been a mainstay of money market funds. Not backed by the full credit of the issuer, commercial paper is essentially an IOU. In the case of SIVs, these vehicles have been used to finance and are backed by a variety of long-term financial instruments, some of which may in turn be secured by mortgages. With delinquencies rising, the value of the mortgages backing the securities has fallen and the market for this type of commercial paper has dried up despite — or perhaps due to — the lack of clarity as to what extent the underlying instruments have been or will be actually impacted by mortgage defaults. When the issuers cannot "roll over" their outstanding paper, the SIVs are at risk of default unless their long-term assets can be sold to pay off the maturing debt.

CASH RESERVES AND THE CREDIT CRUNCH (continued from page 3)

The market for SIVs has existed for several years. Most had received "AAA" ratings and many have now been downgraded or are under review by the rating agencies. Many SIVs will emerge unscathed because their underlying investments have little or no exposure to sub-prime mortgages or other low-quality instruments. Nevertheless, because of the uncertainty in valuation that is at the crux of the current credit crunch, it will be a while before all is sorted out. Three major banks are working to assemble a "super-fund" aimed at providing liquidity to troubled SIVs and restoring investor confidence.

To the best of our knowledge, no Massachusetts city or town is at risk of losing money in its cash reserve holdings. Treasurer Cahill recently disclosed that the $5.6 billion Massachusetts Municipal Depository Trust (managed by Fidelity Investments) has about 2% of its assets invested in six SIVs but none have defaulted and less than half the total market value of them is under review for possible downgrades. Municipalities that have their cash reserves with major banks have not been informed of any risk to their investment principal. The PRIM Board recently stated that none of its cash reserves are at risk.

TAKING STOCK OF STOCKS (continued from page 2)

particularly vivid reminder of what we've frequently noted over the years: that a retirement board cannot be satisfied by simply having an allocation to "equities". A board must closely monitor managers' exposures to the several subclasses, styles, and industrial sectors that constitute the market. Over time, performance will be closely linked to how well equity portfolios are diversified among the constituent factors.

While we may need to analyze and monitor the various subclasses, styles, and sectors of the equity market more and more, it is also important to note that the overall asset class matters less and less to an increasing number of institutional investors. Irrespective of current concerns over the US credit crisis, the falling dollar, and the threat of recession, many large public pension funds are already well along in following the example of large endowment funds in executing a gradual reduction of US stock holdings as a percentage of their total portfolios.

Large public funds in New York, Texas, and Florida are among those that have embarked on this path and CalPERS has a major re-allocation on its near-term agenda. MassPRIM has reduced its domestic equity allocation from 42% in 2001 to less than 30% currently and has a long-term target of 26%.

In some cases, the funds are reallocating from domestic stocks to international holdings. In others, the funds have sought portfolio diversification by increased investments in hedge funds, private equity, and real estate.

In most cases, fund officials acted on the basis of a fact that many of us still have a difficult time grasping. That fact is that returns from stocks are historically very volatile, more so than those of other asset classes or investment types that may seem inherently more risky. While market volatility can be a good thing for hedge funds as they search for aberrations in the market, volatility is something public pension funds generally seek to minimize. (With twenty daily swings of at least 2%, the US stock market so far in 2007 has been the most volatile since 2002.) Accordingly, in consideration of return expectations for US stocks, other asset classes appear better on a risk/return basis and also have distinct diversification benefits.

2008 PUBLIC PENSION INSTITUTE (continued from page 1)

message about the commitment to fulfilling those obligations, so does participating in the Institute at Amherst.

We're now building a curriculum that includes (but is not limited to) a comprehensive review of the basics for the many new board members and administrators: organizing a board meeting, preparing for an audit, understanding actuarial basics, calculating benefits, processing disability retirement, and retirement board accounting. More experienced board members and administrators will focus on: pension related changes in the Massachusetts General Laws and federal statutes, mock valuation and audit report debriefings, tax issues and the Qualification Letter, a case study on planned funding, and GASB 45 and the health care trust. There will also be time for consulting with PERAC staff on a one-on-one basis. This is an ambitious program and it is still being developed. But we wouldn't devote hundreds of hours to preparing for this event if we did not share the often voiced opinion of board members and administrators that pension education and outreach efforts must include an intensive approach such as the one I have outlined.

Later in January, we will be sending out detailed information about obtaining overnight accommodations at discounted rates in Amherst. PERAC has reserved a block of 56 rooms at the UMass Campus Center Hotel. The number of available rooms is somewhat limited because some areas of the Hotel will be undergoing renovations. In light of that, we have also reserved blocks of rooms at four area hotels. The University Lodge (within walking distance of the Campus Center at UMass), the Holiday Inn Express, the Courtyard, and the Econo Lodge are just minutes away. These hotels are competitively priced with the Campus Center Hotel. Please hold off on making reservations at the aforementioned hotels until you have the details you'll receive in January. There are certain codes, etc. that you will need to reference.

We look forward to seeing you in Amherst in August. It is my hope that board members and administrative staff from every retirement system will attend the Institute.